

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 CIAE-00 PM-04 INR-07 L-03 ACDA-10
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UNCLAS SECTION 1 OF 2 USNATO 1175

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TAGS: MARR NATO
SUBJ: INFRASTRUCTURE USE OF REALISTIC CURRENCY EXCHANGE RATES
TO ESTABLISH VALUE OF THE INFRASTRUCTURE ACCOUNTING UNIT
(IAU)

REF: (A) C-M(73)71, 13 SEP 73; (B) USNATO LETTER INFRA
2023/75, 12 MAR 76; (C) USNATO LETTER INFRA 2044/75,
3 APR 75; (D) AC/4-D/2432, 14 JAN 76; (E) AC/4-D/2472,
1 OCT 76.

SUMMARY: AFTER TWO YEARS OF DIFFICULT DISCUSSIONS AND
NEGOTIATIONS, THE INFRASTRUCTURE COMMITTEE IS APPROACHING
AGREEMENT ON A METHOD BY WHICH THE INFRASTRUCTURE ACCOUNT-
ING SYSTEM CAN BE MODIFIED TO TAKE ACCOUNT OF FLOATING
CURRENCIES. ACTION REQUESTED: WASHINGTON CONCURRENCE
IN EMERGING CONSENSUS FOR USE OF THE NEW PROCEDURE FOR
A ONE-YEAR TRIAL PERIOD. END SUMMARY.

1. IN RESPONSE TO THE DYNAMIC SWINGS IN CURRENCY CONVERSION
RATES RESULTING FROM THE "FLOAT OF 1973,
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THE MILITARY AND CIVIL BUDGET COMMITTEES DEVISED A
METHOD BY WHICH A VALUE OF THE NATO BUDGET ACCOUNTING
UNIT COULD BE MAINTAINED AT APPROXIMATELY BANK RATES
EXISTING ON DATES OF PAYMENT. THIS SYSTEM, WHICH USED
THE BELGIAN FRANC AS THE STANDARD, WAS ADOPTED IN REF
A, AND HAS BEEN IN FORCE SINCE MID-1973. THE INFRA-
STRUCTURE ACCOUNTING SYSTEM WAS NOT MODIFIED AT THAT
TIME BECAUSE, WITH ITS MORE COMPLICATED, LONG-TERM
FINANCIAL IMPLICATIONS, IT WAS NOT CLEAR THAT THE
MILITARY AND CIVIL BUDGET COMMITTEE FORMULA WOULD ACHIEVE

PROPER ADJUSTMENTS.

2. AN INFRASTRUCTURE COMMITTEE WORKING GROUP WAS CHARGED WITH THE STUDY OF THE ABOVE PROBLEM, BUT HAD DIFFICULTY IN COMING TO GRIPS WITH IT BECAUSE OF VARIOUS NATIONAL POSITIONS. IT BECAME CLEAR, HOWEVER, IN EARLY 1975, THAT LACK OF ACTION WAS CREATING MAJOR DISTORTIONS IN PAYMENT OF THE RESPECTIVE COUNTRIES' SHARES, WHICH IN TURN CONSTITUTED A DE FACTO MODIFICATION OF THE COST SHARING FORMULA. WE FURNISHED TWO STUDIES (REFS B AND C) TO THE INFRASTRUCTURE COMMITTEE AND ITS WORKING GROUP INDICATIONS THAT IN THE THIRD QUARTER 1974, COUNTRIES PAYING IN HARD CURRENCIES WERE PENALIZED ABOUT 10 PCT, WHILE OTHER COUNTRIES BENEFITED BY AS MUCH AS 25 PCT REDUCTION IN THEIR PAYMENTS. IN JUNE 1975, MR. LOVELAND DISCUSSED THIS SITUATION WITH OASD(ISA), OASD(COMPT), AND TREASURY OFFICIALS. WE CONCLUDED AT THAT TIME THAT A MODIFICATION WAS NECESSARY IN ORDER TO ACHIEVE EQUITABLE INFRASTRUCTURE ACCOUNTING. TWO METHODS WERE AVAILABLE: USE OF A SYSTEM SIMILAR TO THAT OF THE NATO BUDGET COMMITTEES, I.E., THE "NATO RATE", OR ESTABLISHMENT OF A NATO BASKET CURRENCY SIMILAR TO THE IMF'S SPECIAL DRAWING RIGHTS. IN EXAMINING THE TWO POSSIBILITIES, IT BECAME CLEAR THAT ANY ADVANTAGES OF THE SDR SYSTEM WOULD BE OUTWEIGHED BY THE INHERENT DISADVANTAGE OF CHANGES TO ALL CURRENCY RATES AT EVERY INSTANCE OF A DEVALUATION
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OR REVALUATION BY ANY MEMBER CURRENCY. THIS PHENOMENON IS MORE FULLY EXPLAINED IN REFS D. AND E.

3. SINCE MID-1975, BOTH THE INFRASTRUCTURE COMMITTEE AND ITS WORKING GROUP HAVE BEEN ACTIVELY NEGOTIATING A MODIFICATION IN THE ACCOUNTING SYSTEM, WITH MOST NATIONS AGREEING TO THE ESTABLISHMENT OF SOMETHING SIMILAR TO THE BUDGET COMMITTEES' SYSTEM, BUT ITALY AND THE UK FAVORING SOMETHING LIKE THE SDR OR A NATO BASKET. IN THE MEANTIME, THE COMMITTEE HAD AGREED THAT WHATEVER SYSTEM WAS EVENTUALLY ADOPTED WOULD APPLY AS FROM 1 JULY 1975. THIS AGREEMENT WAS NECESSARY IN ORDER TO REMOVE THE MOTIVATION OF THE UK AND ITALY TO DRAG THEIR FEET IN VIEW OF THE ADVANTAGE TO THOSE COUNTRIES OF MAINTAINING A STATUS QUO WHEREBY THEIR CURRENCY VALUES WERE OVERSTATED BY AS MUCH AS 50 PCT. SUBSEQUENT DISCUSSIONS WITHIN THE COMMITTEE AND WITH THE PARTICIPATION OF THE UK AND ITALIAN TREASURY OFFICIALS HAVE NOW RESULTED IN A NEAR CONSENSUS TO APPLY A MODIFIED NATO RATE SYSTEM TO INFRASTRUCTURE FOR A ONE-YEAR TRIAL PERIOD (1977). BOTH ITALY AND THE UK HAVE, HOWEVER, INSISTED THAT THE RETROACTIVITY TO 1 JULY 75 SHOULD BE BASED ON THEIR NEWLY DECLARED RATES (SOME 6 TO 8 PCT BELOW REALISTIC RATES) FOR THEIR CURRENCIES FOR THE PERIOD CONCERNED.

4. THE SYSTEM WHICH APPEARS TO HAVE GENERAL APPROVAL
WOULD BE BASED ON THE ESTABLISHMENT OF A NATO RATE FOR

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THE IAU ON 1 JANUARY AND 1 JULY OF EACH YEAR. THE RATES
WOULD BE CALCULATED AGAINST THE BELGIAN FRANC AT A
CONSTANT EXCHANGE RATE TO THE IAU (136.24) AS LONG AS
THE BELGIAN FRANC IS MAINTAINED WITHIN THE EUROPEAN COMMON
MARKET "SNAKE IN THE TUNNEL". CALCULATION
WOULD BE FURTHER BASED ON THE AVERAGE RATE OF INDIVIDUAL
CURRENCIES AGAINST THE BELGIAN FRANC FOR THE SIX MONTHS
PRECEDING EACH CALCULATION. APPLICATION OF THE NEW
SYSTEM WOULD RESULT IN USE OF THE LATEST RATE AT THE
TIME OF EACH SEMI-ANNUAL FINANCIAL REPORT BY HOST NATIONS.
SINCE SUCH REPORTS MAKE FORECASTS OF FUNDS REQUIRED FOR
A FUTURE PERIOD, THE USE OF THE LATEST RATE MAY LEAD
TO OVER- OR UNDERPAYMENT. THESE ANOMOLIES WOULD BE
CORRECTED, HOWEVER, IN A LATER PAYSHEET WHEN ACTUAL
EXPENDITURES DURING THE PERIOD WOULD BE REPORTED AT A
LATER RATE WHICH CONSTITUTED THE AVERAGE RATE DURING THE
PERIOD OF EXPENDITURE, AND HENCE WOULD BE AS ACCURATE AS
WE KNOW HOW TO MAKE IT.

5. WE BELIEVE THAT WE HAVE THOUGHT OUT THE EFFECTS OF
THIS SYSTEM, AND THAT THEY WOULD BE HIGHLY BENEFICIAL
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TO THE PROGRAM. IN PARTICULAR, THEY WOULD CORRECT THE
CURRENT SITUATION WHEREBY CALLS FOR CONTRIBUTIONS ARE
OVERSTATED BY AS MUCH AS 10 PCT, RESULTING IN BOTH A
LOSS OF IAJS AVAILABLE WITHIN THE SCARCE INFRASTRUCTURE
FUNDS, AND INCREASED CALLS ON THOSE NATIONS PAYING IN

STABLE CURRENCIES. IN ADDITION, IT WOULD ELIMINATE THE SITUATION WHEREBY THE UK, ITALY, CANADA, GREECE, TURKEY, AND THE US HAVE BEEN ABLE TO PAY THEIR CONTRIBUTIONS AT CONSIDERABLY LESS THAN BANK RATES FOR THEIR CURRENCIES. AN ILLUSTRATION OF THIS EFFECT IS GIVEN BY OUR EXPERIENCE OVER THE LAST 18 MONTHS IN SETTLING OUR INFRASTRUCTURE CONTRIBUTIONS AT AN AVERAGE OF \$3.25/IAU, WHILE BANK RATES WOULD HAVE AVERAGED CLOSER TO \$3.65/IAU.

6. WHEREAS THE NEW SYSTEM WILL RESULT IN A SLIGHTLY HIGHER US EXPENDITURE, WE BELIEVE IT NECESSARY, BOTH FOR REASONS OF EQUITY AND TO ENABLE THE INFRASTRUCTURE PROGRAM TO PROCEED ON AN ORDERLY FINANCIAL BASIS. SINCE THE US IS NOT A MAJOR HOST NATION FOR INFRASTRUCTURE PROJECTS, THE NEW PROCEDURE WILL HAVE RELATIVELY LITTLE EFFECT ON OUR SEMI-ANNUAL FINANCIAL REPORTS. ITS PRINCIPAL IMPACT ON THE US WILL BE IN EQUALIZING THROUGHOUT ALL NATO NATIONS THE FINANCIAL CONTRIBUTION IN REAL TERMS.

7. THE RATES WHICH HAVE BEEN CALCULATED FOR NATO CURRENCIES AGAINST THE IAU AS OF 1 JANUARY 1977 ARE AS FOLLOWS. THE CURRENTLY APPLIED RATES ARE GIVEN FOR COMPARATIVE PURPOSES:

COUNTRIES	CURRENT RATE	1 JAN 77 RATE
BELGIAN FRANC	136.24	136.24
CANADIAN DOLLAR	3.50	3.53
DANISH DRONER	21.50	21.46
FRENCH FRANC	15.55	17.74
GERMAN MARK	8.85	8.85
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GREEK DRACHMA	91.20	132.73
ITALIAN LIRA	2080.	3051.
LUXEMBOURG FRANC	136.24	136.24
NETHERLANDS GUILDER	9.394	9.31
NORWEGIAN KRONER	19.19	19.32
PORTUGUESE ESCUDOS	85.765	112.60
TURKISH LIRA	47.29	58.47
BRITISH POUNDS STERLING	1.50	2.10
U.S. DOLLAR	3.38	3.59

IN THE FUTURE, THESE RATES WILL BE CHANGED ONLY WHEN THE CALCULATED RATES INDICATE A CHANGE OF AT LEAST 2.25 PCT.

8. IT WOULD APPEAR THAT WE WILL HAVE AN AGREEMENT ON THE USE OF THE ABOVE RATES FOR 1977 VERY SHORTLY. SEVERAL ASPECTS, HOWEVER, INCLUDING THE RETROACTIVITY TO 1 JULY 75, WILL REQUIRE ADDITIONAL DISCUSSION.

9. REQUEST WASHINGTON CONCURRENCE TO THE APPLICATION OF

THE NEW ACCOUNTING SYSTEM FOR THE TRIAL PERIOD OF ONE
YEAR. STRAUSZ-HUPE

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